85-1028

Supreme Court, U.S.
FILED
NOV
DEC 14 1985
JOSEPH F. SPANIOL, JR.
CLERK

NO. 85-_____

IN THE

Supreme Court of the United States

OCTOBER TERM, 1985

JON-T. CHEMICALS, INC. and Its Receiver,
LEWIS M. OVERTON, JR.,
Petitioners,

v.

UNITED STATES OF AMERICA,
Respondent.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT

BRANTLY HARRIS
Two Shell Plaza, Suite 2299
777 Walker Street
Houston, Texas 77002
(713) 228-3040

Attorney for Petitioners

Alpha Law Brief Co., Inc.—5606 Parkersburg—Houston, Texas 77036—223-3003

QUESTIONS PRESENTED

1. In an action by the United States against a corporation based upon the prior criminal conviction of its wholly-owned subsidiary, is it necessary to prove some inequitable conduct on the part of the parent corporation, which resulted in injury to the United States? Or may liability be predicated on a "laundry list of factors," not in themselves inequitable, such as having common officers and directors, filing consolidated income tax returns, use of common offices and the same computer, and the like?

2. In a tort action to pierce the corporate veil of a corporation based upon alleged gross undercapitalization, must the fair market value of all corporate assets be considered, and not merely the corporation's formal capitalization?

3. Is an action by the United States under the False Claims Act governed by the federal common law?

4. Is the district court's determination that the subsidiary was the "alter ego" of the parent corporation a finding of fact governed by the "clearly erroneous" standard of review provided by Federal Rule 52(a)?

5. Did the Court of Appeals err in holding Jon-T. Chemicals, Inc. liable for the crimes committed by its subsidiary, Jon-T. Farms, Inc. and John H. Thomas?

TABLE OF CONTENTS

	Page
QUESTIONS PRESENTED	I
TABLE OF AUTHORITIES	III
OPINIONS BELOW	IV
JURISDICTION	IV
STATUTES INVOLVED	1
STATEMENT OF THE CASE	1
REASONS FOR GRANTING THE WRIT	10
CONCLUSION	24
CERTIFICATE OF SERVICE	25
APPENDIX:	
A OPINION OF THE UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT	A1
B JUDGMENT, AND ORDER IN CONNECTION WITH POST-TRIAL MOTIONS, OF THE UNITED STATES DISTRICT COURT FOR THE NORTHERN DISTRICT OF TEXAS	B1
C STATUTE	C1
False Claims Act, 31 U.S.C. §§ 3729-3731	

TABLE OF AUTHORITIES

CASES	Page
Anderson v. Abbott, 321 U.S. 349 (1944)	19
Baumgartner v. United States, 322 U.S. 665 (1944)	12
Beyer v. LeFevre, 186 U.S. 114 (1902)	12
Branscum v. Castleberry, 695 S.W.2d 643 (Tex. Civ. App. 1985)	12
Donnell v. Herring-Hall-Marvin Safeco, 208 U.S. 267	23
First City National Bank v. Banco Para El Comercio, 462 U.S. 611, 103 S. Ct. 2591, 77 L.Ed.2d 46	10, 11, 12
Klein v. Board of Supervisors, 282 U.S. 19 (1930)	23
Lucas v. Texas Industries Inc., 696 S.W.2d 372 (1984)	20
Matter of Mobile Steel Co., 563 F.2d 692 (5th Cir. 1977)	16
NLRB v. Deena Artware, Inc., 361 U.S. 398, 80 S. Ct. 441, 44 L.Ed.2d 400 (1960)	20
Pepper v. Litton 308 U.S. 295 (1939)	16
Schenley Distillers Corp. v. United States, 1946, 326 U.S. 432, 66 S. Ct. 247, 90 L.Ed. 181 (1946)	18
Torregrossa v. Szelc, 603 S.W.2d 803 (Tex. Sup. 1980)	20
United States v. Kimbell Foods, Inc., 440 U.S. 715, 99 S. Ct. 1448, 59 L.Ed.2d 711 (1979)	10
United States v. Pisani, 646 F.2d 83 (3rd Cir. 1981)	10

UNITED STATES STATUTES	
31 U.S.C. §§ 3729-3731 (False Claims Act)	1

FEDERAL RULES OF CIVIL PROCEDURE	
Rule 52(b)	10, 12

MISCELLANEOUS	
William O. Douglas and Carol Shanks, *Insulation from Liability through Subsidiary Corporations*, 39 Yale L.J. 193 (1929)	19
Fletcher Cyc. Corps. § 43, p. 472 (Cum. Supp. 1985, p. 45)	19
Note: Piercing the Corporate Veil: The Alter Ego Doctrine Under Federal Common Law, 95 Harv. L. Rev. 853 (1982)	20

OPINIONS BELOW

The opinion of the Court of Appeals is reported at 768 F.2d 686. The final judgment of the District Court and the orders in connection with posttrial motions (B1-B11) are not officially reported.

JURISDICTION

The judgment of the Court of Appeals was entered on August 16, 1985. The jurisdiction of this Court is invoked under 28 U.S.C. § 1254(1).

NO. 85-_____

IN THE

Supreme Court of the United States

OCTOBER TERM, 1985

JON-T. CHEMICALS, INC. and Its Receiver,
LEWIS M. OVERTON, JR.,
Petitioners,

v.

UNITED STATES OF AMERICA,
Respondent.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT

STATUTES INVOLVED

The False Claims Act, 31 U.S.C. §§ 3729-3731 (previously 31 U.S.C. §§ 231-235) is appended (C1).

STATEMENT OF THE CASE

Petitioner, Jon-T. Chemicals, Inc. ("Chemicals"), has been held liable in treble damages for more than $4.7 million based upon crimes committed in 1972 and 1973 by its wholly-owned farming and ranching subsidiary, Jon-T. Farms, Inc. ("Farms") and by John H. Thomas, majority stockholder of Chemicals.[1]

Farms and Thomas were previously convicted of making false statements to the Commodity Credit Corporation

1. This total amount is $4,787,604.20 computed as follows: (a) on Count I of the amended complaint under the False Claims Act, $4,517,202.30 which equals double the Government's actual damages of $2,263,601.15, less $15,500.00 previously recovered, plus $6,000.00 in statutory forfeitures, and (b) on Count III of the amended complaint for conversion, $269,901.90 (Pre-Trial Order ¶ 108, R. 401).

in 1972 and 1973 to obtain agricultural subsidies and of conversion of CCC property by arranging crop support payments for persons not qualified to receive them (A1). Chemicals was never charged with any crime. In this subsequently-filed civil action the government asserted that Chemicals was liable for the acts of Farms and Thomas based upon the alter ego doctrine. The district court at the conclusion of a two-day nonjury trial held that Chemicals was liable (B2) and entered judgment in favor of the government against Chemicals (B3).

The district court held Chemicals liable, on essentially two grounds: (i) that Farms was the alter ego of Chemicals (B3, B9), and (ii) that Thomas was acting in his capacity as president of Chemicals when he committed the crimes (B7). In support of the alter ego determination, the district court collected a number of factors as to which the evidence was undisputed. However, the district court also made findings or conclusions which Petitioners challenged on appeal: (i) gross undercapitalization, (ii) "co-mingling and integration of all corporate activities of each corporation, as well as a co-mingling of their corporate funds . . ." (B8), and (iii) "a direction and supervision by Chemicals and its officers and directors of the activities and functions of Farms to such an extent that they can only be considered as one enterprise" (B9). The Court of Appeals affirmed on the following grounds: (i) treating the alter ego determination as a finding of fact, it held the determination properly to be based on "a laundry list of factors (A8)" and not clearly erroneous, (ii) it affirmed the district court's finding that Farms "operated with a grossly inadequate capital" (A15), and (iii) it affirmed the district court's finding of commingling of assets and funds (A16-17) and tacitly affirmed the district court's further finding of "commingling and in-

tegration of all corporate activities" and "direction and supervision by Chemicals . . . of the activities and functions of Farms to such extent that they can only be considered as one enterprise" by saying that Chemicals "exercised total domination and control over Farms" (A13), finally characterizing the parent-subsidiary relationship as a fantasy (A19), and affirming the judgment.

Chemicals was incorporated in Oklahoma in 1969 to engage in the chemicals and fertilizer business (A4). Chemicals was an accrual-basis taxpayer (Pre-Trial Order, ¶ 240, R. 426).

Farms was incorporated in Texas in April, 1971 to engage in farming and ranching (Pre-Trial Order ¶ 243, R. 427). Farms was a cash-basis taxpayer (Pre-Trial Order ¶ 243, R. 427). By incorporating Farms as a separate, cash-basis taxpayer, it was possible to defer income from its farming and ranching operations until the crops and livestock were actually sold (Tr. 209, Miller). The United States knew at all pertinent times that Farms and Chemicals were incorporated as two separate corporations and that Farms was the wholly-owned subsidiary of Chemicals (Pre-Trial Order, ¶ 236, R. 426).

Chemicals had four other subsidiaries besides Farms during 1972 and 1973.[2]

---

2. (1) In January 1972 Chemicals purchased all the outstanding common stock of Gaines Development Company, a Texas corporation, which became a wholly-owned subsidiary of Chemicals. (Id., ¶ 337, R. 391.) (2) Jon-T. Chemicals Exports, Inc., a Nevada corporation, was incorporated in February 1972 as a wholly-owned subsidiary of Chemicals. (Id., ¶ 62, R. 394.) (3) Jon-T. Exports, Inc., a Texas corporation, was incorporated in February 1973 as a wholly-owned subsidiary of Chemicals through which Chemicals made export sales of chemical fertilizer (Id., ¶ 51, R. 392.) (4) Weather Watch Instruments, Inc., a Texas corporation, was incorporated in October 1973 (a few months after the last crimes were committed)

The United States introduced into evidence a prospectus with respect to a proposed acquistion of Jon-T. Chemicals, Inc. by McCulloch Oil Corporation, which recites that it was mailed January 17, 1975 (Pl. Ex. 6, Tr. 24). The proposed acquistion did not in fact take place, but the prospectus provides considerable information concerning Chemicals and its subsidiaries, and it is believed that the facts recited in the prospectus are undisputed. It is recited at page 64 thereof,

> "Chemicals operates commercial firms whch principally produce cotton, milo, alfalfa, sorghum, silage, wheat and peanuts, principally through Jon-T. Farms. Inc., a wholly-owned subsidiary . . .".

According to this document revenue from the operations of Farms formed a small part of the overall operations of Chemicals and its subsidiaries during 1971, 1972 and 1973, as shown by the tables appearing at pages 19 and 64. Income from Farms in 1971 was $382,000.00 out of total revenues of Chemicals and its subsidiaries of $16,632,690.00. In 1972 revenues from the operations of Farms amounted to $1,674,000.00 out of total revenues of Chemicals and its subsidiaries of $22,975,751.00. In 1973 the revenues of Farms amounted to $1,352,000.00 out of total revenues for Chemicals and its subsidiaries of $26,450,753.00.

Farms and Chemicals in their respective names maintained separate books of account and bank accounts throughout 1971, 1972 and 1973 (Pre-Trial Order, ¶ 246, R. 427). The financial statements for Chemicals and its subsidiaries for 1971, 1972 and 1973 were audited by

---

as a wholly-owned subsidiary of Chemicals to engage in the manufacturing and selling of a tornado alarm. (Id., ¶¶ 57, 60, R. 394.) Other subsidiaries were incorporated subsequent to the years in question (1972 and 1973).

Peat, Marwick, Mitchell & Co., certified public accountants. The audit each year included a reconciliation of all inter-company accounts between Chemicals and each of its subsidiaries, including Farms. (Pre-Trial Order, ¶¶ 247, 248, R. 427). Chemicals and its subsidiaries filed consolidated income tax returns each year. This allows losses of one company to be offset against the gains of another, thereby reducing tax liability. (Tr. 219, Crow).

Chemicals had six directors.[3] Three of these individuals constituted the board of directors of Farms during 1971, 1972 and 1973.[4] John H. Thomas served as president and chairman of both Chemicals and Farms and Earl Weddle was vice-president of both corporations (B5). Darrell L. Miller, an accountant and a director of both corporations, served as Secretary and Controller of Chemicals and Farms (Pre-Trial Order ¶¶ 9, 31). Robert Kennedy, an accountant who worked under Miller served as Assistant Secretary and Controller of Farms (Id. ¶ 31). Miller and Kennedy did the accounting for Chemicals and all of its subsidiaries, including Farms (Tr. 40, Kennedy) and both were on the payroll of Chemicals (Tr. 48-49, 104, Kennedy).

Minute books were kept by Farms and Chemicals showing that each held separate meetings of stockholders and directors throughout 1971, 1972 and 1973. (Pre-Trial Order ¶ 250, R. 427). The United States offered no evidence to suggest that the meetings reflected by the minute books were not held. There was also undisputed testimony that both companies did hold regular directors

3. John H. Thomas, Earl M. Weddle, Jr., Bruce Zorns, Darrell L. Miller, Dallas Cantwell and Robert L. Crowder. (Pre-Trial Order ¶ 8, R. 385.)

4. John H. Thomas, Earl M. Weddle and Darrell L. Miller. (Id., ¶ 30, R. 389.)

meetings during the period 1971-1973. (Tr. 130, Miller). Some directors' minutes of Farms are in evidence.[5]

Farms leased 7,780 acres of land from John Hancock Life Insurance Company in April, 1971 (Def. Ex. 1 and 2; Tr. 26-31), the month of its incorporation, and the same month purchased three sections of land from an individual (Def. Ex. 5, Tr. 26-31). In October, 1971 Farms contracted to purchase 8147 acres of land from John Hancock Mutual Life Insurance Company (Def. Ex. 33, Tr. 26-31; Tr. 203, Miller) and paid $40,000.00 representing the balance of the down payment to the insurance company (Def. Ex. 36, Tr. 26-31). The board of directors of Farms passed a resolution authorizing the execution of a mortgage with respect to this transaction (Def. Ex. 37, Tr. 26-31). In January, 1972 the insurance company conveyed this 8,147 acres to Farms (Def. Ex. 64, Tr. 26-31; Tr. 182, Miller). Farms paid $46,650.00 to the insurance company in February, 1972 (Def. Ex. 68, Tr. 26-31). Farms borrowed $200,000.00 from a bank in Brownfield, Texas in May, 1972, the transaction being authorized by its directors' resolution (Def. Ex. 75, Tr. 26-31; Tr. 167, Miller). The note to the bank was secured by irrigation systems, tractors and other equipment of Farms (Def. Ex. 86, Tr. 26-31). This loan was not guaranteed by Chemicals.

Farms had only one full-time employee, H. C. Thomas, who served as farm manager. H. C. Thomas contracted with others for various services such as clearing the land, deep breaking the soil, drilling water wells, installing and repairing irrigation systems, purchasing livestock, building a feedlot for the livestock, and farming. (See Defendants' Exhibits 4, 194, 10, 23, 28, 29, 31, 32, 35, 47, 59, 76,

---

5. Def. Ex. 75, Tr. 26-31; Pl. Ex. 9(g), (h), (i), (k), (l), (p), (q), (u), (v), (z), (aa), (bb), (cc), (ee), Tr. 24.

77, 89, 98, 195, 104, 10, 124-1; Tr. 26-31). Charles R. Bruce grew wheat and corn for Farms in 1971, 1972 and 1973 (Tr. 266-270, Bruce).

In 1972 and 1973 Farms leased most of its land to the members of two joint ventures (A2). Charles R. Bruce grew cotton for the joint venturers (Tr. 266-270, Bruce). The members of these joint ventures applied for crop subsidy payments under the Upland Cotton Program. Farms and its president, John H. Thomas, certified that the joint venturers were entitled to the crop subsidy payments under applicable regulations.[6] None of the land which Farms leased to the two joint ventures was owned in the name of Chemicals. (Pre-Trial Order, ¶ 245, R. 427).

It is also stipulated, "John H. Thomas and Farms also

---

6. The pertinent stipulations from the Pre-Trial Order are as follows:

"102. In 1972 and 1973, John H. Thomas and Jon-T. Farms, acting on behalf of the members of the joint ventures, applied for agricultural subsidies under the Upland Cotton Program which were paid to the venturers by the Government in the form of 42 Commodity Credit Corporation ('CCC') sight drafts.

"103. The joint venture members were ineligible for the subsidy payments.

"104. The claims and statements made by John H. Thomas and Jon-T. Farms in applying for the cotton subsidies were false because the joint venturers were not entitled to receive the subsidy payments.

"105. As a result of the false statements and claims by John H. Thomas and Farms, the United States paid out $2,263,601.15 in cotton subsidies to or on behalf of the members of the joint ventures"

(R. 399-400.)

"251. The ASCS Forms 516 (Intention to Participate and Payment Application) and ASCS Forms 580 (Certification of Compliance and Request for Payment), referred to in Count I of the First Amended Complaint, were submitted or caused to be submitted to the Government by John H. Thomas and Farms, *not Chemicals.*"

(R. 427.) (Emphasis supplied.)

converted the proceeds of five CCC sight drafts totalling $269,901.90" (Pre-Trial Order, ¶ 106, R. 400).

The district court did not find that Chemicals incorporated Farms for any unlawful or fraudulent purpose. The district court also did not find that Chemicals received any of the illegal crop subsidy payments.

The capitalization of Farms, in the sum of $10,000.00 (B5) was insufficient for its activities in purchasing and improving large amounts of land and irrigation systems and acquiring livestock and conducting farming operations, and Farms financed its activities during 1971, 1972 and 1973 mainly from advances from Chemicals. Farms also borrowed $200,000.00 from a Brownfield bank. It was stipulated:

> "At least in 1971, 1972 and 1973, it was common for Chemicals to advance funds to Farms because Farms had insufficient cash and needed cash to conduct its business; Chemicals also paid Farms' invoices, bills and expenses, including its payroll, but an account was kept of such payments which were recorded on both companies' books of account as debts owed by Farms to Chemicals."

(Pre-Trial Order, ¶ 118, R. 403).

The crop support payments in question were made in 1972 and 1973. The general ledger of Chemicals, reflecting its on-going advances to Farms, shows the monthly amounts of indebtedness owed by Farms to Chemicals. By December of 1971, the year that Farms was incorporated, Farms owed Chemicals $308,210. A year later this had increased to $681,495.46; by December, 1973, to $1,836,147.56. By January, 1975 Farms owed Chemicals $7.1 million (Pre-Trial Order, ¶ 114, R. 402). At the time of trial, following the 1981 bankruptcy of

Farms, the subsidiary still owed Chemicals $3,258,798 representing "advances for working capital" (Id. ¶¶ 115, 117); that is to say, Farms owed Chemicals $1.4 million more at the time of trial than it owed Chemicals on December 31, 1973, after all of the crimes of Farms and Thomas had been committed.[6a]

6a. The full stipulation as to the status of accounts between Farms and Chemicals is as follows:

"At the end of each of the following months, Chemicals' account number 135-02 contained the indicated debit balance showing the amount of indebtedness owed by Jon-T. Farms to Chemicals:

Date	Debit Balance	Date	Debit Balance
Mar. 1971	$ 26,410.55	Aug. 1973	$1,098,312.51
Apr. 1971	312,069.25	Sept. 1973	1,093,948.61
May 1971	312,724.75	Oct. 1973	1,176,653.80
June 1971	363,106.75	Nov. 1973	1,169,747.90
July 1971	363,487.78	Dec. 1973	1,836,147.56
Aug. 1971	263,787.78		
Sept. 1971	228,387.78	Jan. 1974	1,968,761.11
Oct. 1971	278,387.78	Feb. 1974	1,771,761.11
Nov. 1971	331,782.98	Mar. 1974	1,507,583.93
Dec. 1971	308,210.01	Apr. 1974	1,717,633.07
		May 1974	2,360,890.02
Jan. 1972	534,949.12	June 1974	2,475,332.65
Feb. 1972	821,998.00	July 1974	3,642,168.13
Mar. 1972	821,332.51	Aug. 1974	3,995,186.54
Apr. 1972	522,381.39	Sept. 1974	4,453,089.22
May 1972	523,580.84	Oct. 1974	4,897,274.80
June 1972	549,722.74	Nov. 1974	5,061,379.80
July 1972	559,747.52	Dec. 1974	5,740,732.60
Aug. 1972	591,747.52		
Sept. 1972	619,747.52	Jan. 1975	7,102,499.99
Oct. 1972	643,873.36	Feb. 1975	6,109,013.19
Nov. 1972	512,873.36	Mar. 1975	6,573,048.19
Dec. 1972	681,495.46	Apr. 1975	7,026,595.50
		May 1975	4,852,799.98
Jan. 1973	892,495.46	June 1975	4,511,271.71
Feb. 1973	996,490.45	July 1975	3,894,927.83
Mar. 1973	1,277,545.44	Aug. 1975	4,710,228.88
Apr. 1973	1,326,957.23	Sept. 1975	5,835,636.38
May 1973	1,255,585.53	Oct. 1975	5,525,636.38
June 1973	1,347,418.92	Nov. 1975	5,985,493.21
July 1973	1,160,842.32	Dec. 1975	3,509,593.21"

(Pre-Trial Order ¶ 114, R. 402).

The crimes of Farms and Thomas were committed in 1972 and 1973. Farms continued in business until 1977 and filed a voluntary petition in bankruptcy in 1981 (Pre-Trial Order, ¶¶ 115, 117, R. 403). There is also no finding by the district court that Chemicals milked Farms of its assets so as to cause the 1981 bankruptcy. There is no evidence in the record that John H. Thomas, the majority stockholder of Chemicals, is insolvent, as suggested by the Court of Appeals (A4).

REASONS FOR GRANTING THE WRIT

I.

In this alter ego case brought under the False Claims Act and for conversion of agricultural subsidy payments, Petitioners submit that the Court of Appeals correctly held that federal law governs (A5, n. 6). *United States v. Kimbell Foods, Inc.*, 440 U.S. 715, 726, 99 S. Ct. 1448, 1457, 59 L.Ed.2d 711 (1979); *United States v. Pisani*, 646 F.2d 83, 86-87 (3rd Cir. 1981).

II.

The Court of Appeals treated alter ego as a finding of fact, reviewable under the "clearly erroneous" standard of Rule 52(b). Petitoners submit that alter ego is not a fact but a "worn epithet" given to an equitable theory of recovery. This Court observed in *First City National Bank v. Banco Para El Comercio*, 462 U.S. 611, 103 S. Ct. 2591, 2598, 2601, 77 L.Ed.2d 46:

> "The parties and *amici* have repeatedly referred to the phrases that have tended to dominate discussion about the independent status of separately constituted juridical entities, debating whether 'to pierce the corporate veil,' and whether Bancec is an 'alter ego' or a 'mere instrumentality' of the Cuban Government. In *Berkey v. Third Avenue Railway Co.*, 244 N.Y. 84, 155 N.E. 58 (1926), Justice (then Judge) Cardozo warned in circumstances similar to those presented here against permitting worn epithets to substitute for rigorous analysis. . . ."

(103 S. Ct. at p. 2598).

This Court further explained:

> "In discussing the legal status of private corporations, courts in the United States and abroad, have recognized that an incorporated entity—described by Chief Justice Marshall as 'an artificial being, invisible, intangible, and existing only in contemplation of law'—is not to be regarded as legally separate from its owners in all circumstances. Thus, where a corporate entity is so extensively controlled by its owner that a relationship of principal and agent is created, we have held that one may be held liable for the actions of the other. See *NLRB v. Deena Artware, Inc.*, 361 U.S. 398, 402-404, 80 S. Ct. 441, 443, 4 L.Ed.2d 400 (1960). In addition, our cases have long recognized 'the broader equitable principle that the doctrine of corporate entity, recognized generally and for most purposes, will not be regarded when to do so would work fraud or injustice.' *Taylor v. Standard Gas Co.*, 306 U.S. 307, 322, 59 S. Ct. 543, 550, 83 L.Ed. 669 (1939). See *Pepper v. Litton*, 308 U.S. 295, 310, 60 S. Ct. 238, 246, 84 L.Ed. 281 (1940). In particular, the Court has consistently refused to give effect to the

> corporate form where it is interposed to defeat legislative policies. E.g., *Anderson v. Abbot, supra,* 321 U.S., at 362-363, 64 S. Ct., at 537-38."

(103 S. Ct. at p. 2601).

Necessarily a decision that a corporation is the alter ego of its owner implies the application of equitable considerations and is based on "the whole mass of the evidence," Cf. *Baumgartner v. United States,* 322 U.S. 665 (1944), and *Beyer v. LeFevre,* 186 U.S. 114 (1902). Petitioners submit that the clearly erroneous standard of review prescribed in Federal Rule 52(a) should not inhibit review. Cf. *Branscum v. Castleberry,* 695 S.W.2d 643 (Tex. Civ. App. 1985), where it was recently held that alter ego is a question of law.

If basic unfairness is shown, a court of equity will hold a stockholder liable in much the same way that it would impose a constructive trust. But in this area of the law the chancellor's discretion is not unfettered, for he must live with the principle of limited liability and cannot lightly ignore the existence of a legislatively-mandated creature. For this reason, piercing the corporate veil is similar to going behind the statute of frauds, and clear and convincing evidence of wrongdoing by the parent corporation should be required.[7]

---

7. The chancellor is in some respects like Superman: both have x-ray vision and both act only to prevent injustice. In this case Farms and Thomas have already been held liable without extraordinary, equitable relief, and the only remaining question is whether the chancellor should act to sacrifice the investment of the *minority* stockholders of Chemicals, and the interests of its own creditors.

III.

The facts presented in the case at bar are rather typical —and for that reason are of general significance. A subsidiary is formed to go into a new venture, with tax considerations in mind. Economy is a primary consideration. It is not necessary to rent a different office across the hall, to get another computer, or to hire additional personnel to handle the accounting. Computer programs already in use are adapted to the new subsidiary by the people familiar with the programs. The accountants for the parent corporation do the accounting for the subsidiary. The chief executive of the parent becomes the chief executive of the subsidiary and some of the people on the parent's board of directors are selected to serve as directors for the subsidiary. The formal capitalization of the subsidiary is small. People working for the subsidiary (and other subsidiaries) remain on the payroll of the parent, which in effect donates their services. Rent is not charged and thus office space is also donated. The parent corporation makes frequent advances to the subsidiary and purchases things for its account, but a careful record is kept and the financial records are audited, both in order to keep track of the profitibility of the enterprise as well as to have proper records for payment of income taxes. Consolidated tax returns are filed, in order that losses from one corporation can be offset against income from another and so income taxes can be minimized. The new venture proves to be unprofitable for a variety of reasons and the parent corporation loses $3.2 million on its investment. Should the parent corporation also lose the defense of limited liability? The Court of Appeals answered this question in the affirmative, reasoning in effect that by making a

series of advances in the first instance the parent corporation in effect commits itself to make all future advances which may be necessary to defray all obligations of the subsidiary (A15-16). But that is like saying that if your aunt sent you to college, she has to support you for the rest of your life.

IV.

Many start-up companies experience a negative cash flow. That does not mean that they have a negative net worth. Farms was engaged in acquiring more than 15,000 acres of land in the Texas Panhandle by purchase and lease, deep breaking the soil so it could be cultivated, installing and repairing extensive irrigation systems, farming and ranching, besides leasing most of its land to others in 1972 and 1973. The activities of Farms required a great deal of money without bringing in any appreciable return. This did not mean it was insolvent. See Bartczak, "Cash Flow—It's Not the Bottom Line," Harvard Business Review, July-August 1984, No. 4, p. 61. The government did not offer any evidence that Farms was insolvent based on the fair market value of its fixed assets during the years when the crimes were committed.

It is also common for the negative cash flow of start-up corporations to be remedied by advances from stockholders. In the context of one corporation owning another, it is not surprising that these advances are made informally, so long as an accounting is kept. There is no practical reason to take collateral for such loans, since the parent corporation owns all of the subsidiary's stock, and taking collateral would only impair the subsidiary's later efforts to borrow from others. The making of such advances is as equally consistent with an innocent interest in the

subsidiary as with the commission of any crime and hence does not constitute any evidence of wrongdoing. It will be noted that on any given day a prospective purchaser of Farms could have learned exactly what he was buying. The financial identities were kept intact. There was not a de facto merger.

It is clear from the wording of the trial court's finding that Farms acted with a "grossly inadequate capital", that it was based upon only two factors, the formal capitalization of Farms of $10,000.00 and the fact that it borrowed large sums from Chemicals with which to conduct its operations. That is what the trial court said.[8] Thus the district court did not consider the net worth of Farms based on the fair market value of its assets. The government simply did not address this question. The Court of Appeals in its opinion likewise overlooked the relevance of fair market value of its thousands of acres of land, irrigation systems, livestock and other assets. The effect of this is to assume that the sums advanced by Chemicals to Farms were simply wasted. They were not. Obviously the fair market value of a corporation's assets should not be ignored in equity, where the alter ego doctrine is administered, because it determines what would be available to creditors at any given time.

The government also failed to prove any connection between the negative cash flow experienced by Farms and any injury to the government. Chemicals, which had advanced $1.8 million to Farms by the end of 1973,

---

8. "After examining the original capital structure of the corporation, as above set forth, and the amounts subsequently borrowed by Farms from Chemicals, and the large sums of money needed to operate Farms the court finds that Farms operated with a grossly inadequate capital." (Finding 5, B5.)

proceeded to *increase* its loan to Farms to $5.7 million in 1974 and $7.1 in January, 1975 (Pre-Trial Order, ¶ 114, Tr. 402).

The Supreme Court of the United States should clarify the law on undercapitalization as a basis for piercing the corporate veil in a tort case. Should a court of equity look only to the formal capitalization of a corporation in determining whether to pierce the corporate veil? That would be unfair. It is for the Legislature in the first instance to specify the minimum capitalization of a corporation. In a given tort case, if a court of equity thinks a corporation is so underfinanced that its organizers have intentionally set loose upon society a basically unfair device, then it should hold the stockholders liable for doing so, but in making this evaluation the court should consider the total flow of funds, not just the formal capitalization. It should consider the fair market value of the assets purchased with those funds. In making this analysis the court may transpose loans into contributions of capital in judging the fairness of what happened. *Pepper v. Litton,* 308 U.S. 295 (1939).[9] That is to say, if a court of equity can consider loans as contributions of capital for purposes of subordinating claims in a bankruptcy proceeding, it certainly makes sense to do so in making an equitable evaluation of alleged undercapitalization in an alter ego case. Of course, it is not necessary even to make this additional analysis *unless* the corpora-

---

9. Indeed, in its trial brief in the district court the government conceded: "In these circumstances, it is proper to treat these fund transfers not as loans or advances as they were recorded on the books of account of Farms and Chemicals, but as capital contributions to Farms by its sole shareholder, Chemicals. *See Pepper v. Litton*, 308 U.S. 295, 309-10 (1939); *Matter of Mobile Steel Co.*, 563 F.2d 692, 702-03 (5th Cir. 1977)." (p. 15.)

tion appears insolvent based on the *fair market value* of its assets at or about the time when the injury complained of occurred.

V.

The pernicious effect of considering alter ego as a question of fact to be decided on the basis of a "laundry list of factors (A8)" is that liability is apt to be based upon innocent conduct, such as the fact that a parent corporation and its subsidiary filed consolidated tax returns, as permitted by law, or shared offices or had the accountants for the parent corporation do the accouting for the subsidiary. The courts should encourage efficiency in American business. Surely the fact that a parent corporation and its subsidiary use the same computer is innocent, not suspect.

The alter ego question should not be resolved except in the context of the particular plaintiff's cause of action. Consider, for example, the "factor" that the parent and its subsidiaries use the same office. If the plaintiff were a tradesman who was confused by this fact, the sharing of offices may be considered an inequity justifying relief. But it is stipulated here that the Government was always aware of the separate corporate identities of Chemicals and Farms (Pre-Trial Order, ¶ 236, R. 426). The problem with the "factors" approach is through a collection of such factors the parent corporation can be held liable for activities which are innocent in themselves. The fact that the subsidiary pays no rent represents, in effect, a donation to the subsidiary. The fact that the people who worked for the subsidiaries of Chemicals did not keep time records or allocate their time among various corporations, and were on the payroll of the parent

corporation also represents a donation to the subsidiary —not a loan, but a tacit contribution of capital. Such factors are helpful to the subsidiary, not pernicious. They tend toward the success of the subsidiary. There must always be a clear distinction taken between milking a corporation and giving it a transfusion. In any alter ego case the question should be whether the party whom the plaintiff seeks to hold liable has done something inequitable, and, equally important, whether this conduct proximately caused the very injury of which the plaintiff complains. This Court has said:

> "While corporate entities may be disregarded where they are made the implement for avoiding a clear legislative purpose, they will not be disregarded where those in control have deliberately adopted the corporate form in order to secure its advantages and where no violence to the legislative purpose is done by treating the corporate entity as a separate legal person."

Schenley Distillers Corp. v. United States, 1946, 326 U.S. 432, 437, 66 S. Ct. 247, 249, 90 L.Ed. 181, 184 (1946).

The district court has not found that Chemicals caused Farms to be incorporated for the purpose of violating federal statutes, or for any other illegal or wrongful purpose; neither has the district court found that Chemicals received any of the illegal crop support payments. Only if an injustice on the part of *Chemicals* were shown would a court of equity be justified in sacrificing the investment of its minority stockholders and prejudicing the rights of its own creditors. The government already has a judgment against Thomas.

> "Generally, absent fraud or bad faith, a corporation will not be held liable for the acts of its sub-

> sidiaries. There is a presumption of separateness that, in order to establish liability, the plaintiff must overcome by showing that the parent is employing the subsidiary to perpetrate a fraud and that this was the proximate cause of the plaintiff's injury. Merely showing control, in the absence of an intent to defraud or escape liability, is insufficient to overcome the presumption. Further, although wrongdoing by the parent need not amount to plain fraud or illegality, the injured party must show some connection between its injury and the parent's improper manner of doing business—without that connection, even when the parent exercises domination and control over the subsidiary, corporate separateness will be recognized."

Fletcher Cyc. Corps. § 43, page 472 (Cum. Supp. 1985, page 45).

The "factors" approach of the Fifth Circuit has its apparent origin in a Law Review article, by William O. Douglas and Carol Shanks, *Insulation from Liability through Subsidiary Corporations,* 39 Yale L.J. 193 (1929). Douglas then was a thirty-two-year-old professor at the Yale Law School, and the article was primarily a "how-to" article for corporate counsel, addressed to the subject of how to avoid alter ego litigation. The "factors" represented things one should or should not do, to avoid a problem. The article is *not* a diagnostic tool to resolve alter ego cases. To use an analogy, a heart doctor may advise his patient not to eat eggs and to get plenty of exercise, but if the patient later came to him for a diagnosis, the doctor would not begin by asking the patient if he had eaten eggs or had plenty of exercise; he would take out his stethoscope. Justice Douglas did not cite his own "how-to" article in *Anderson v. Abbott,* 321 U.S. 349 (1944), in which this Court pierced the

corporate veil of a bank holding company in order to give effect to a liability on bank stockholders imposed by statute. He also did not cite it in *NLRB v. Deena Artware, Inc.*, 361 U.S. 398, 80 S. Ct. 441, 4 L.Ed.2d 400 (1960).

In a recent note collecting the cases the view has been expressed that the federal common law with respect to the alter ego doctrine is in a state of "chaos". *Note: Piercing the Corporate Veil: The Alter Ego Doctrine Under Federal Common Law*, 95 Harv. L. Rev. 853 (1982) at page 859. But the commentator does not choose the "factors" approach of the Fifth Circuit: instead it is stated,

> "The true test must be whether the corporation was created for a legitimate business purpose or primarily for evasion of a federal policy or statute." (p. 868)

Although the Court of Appeals in this case has minimized the discrepancy between its ruling and the law of Texas (A5, n. 6), the test in Texas is not "factors" but injustice: whether the corporation was used by its owners as "an unfair device designed to achieve an inequitable result", *Torregrossa v. Szelc*, 603 S.W.2d 803 (Tex. Sup. 1980). The Texas Supreme Court more recently has held that the following "factors" collectively constitute "no evidence" of alter ego in a tort case: that the parent and subsidiary had some of the same officers and directors; that they filed a consolidated income tax return and that they used the same corporate logo, the court stating "We hold that the evidence introduced by [the plaintiff] is no evidence of alter ego." *Lucas v. Texas Industries, Inc.*, 696 S.W.2d 372, 376 (1984). Petitioners submit that under Texas law, and what should be the federal

common law, the corporate veil should not be pierced unless the *stockholder* was guilty of inequitable conduct such as if he used the corporation as a basically unfair device, abusing the principle of limited liability. Equally important, the paricular misconduct of the stockholder must have resulted in injury to the plaintiff.

VI.

The opinion of the Court of Appeals throws little light on what facts may be denoted by the term "total domination and control" in a parent-subsidiary context. The court mentions the frequent cash advances by the parent to the subsidiary, but these do not show domination. It has been proven that the three-man board of directors of Farms was made up of individuals who also served on the six-man board of Chemicals. Although John H. Thomas was president and chairman of Farms, he was only one of three votes on its board. The record contains many minutes of directors' meetings of both Chemicals and Farms. What takes place at directors' meetings are not just "corporate formalities", but meaningful, substantive corporate *acts*. It is preparing minutes of a meeting that is the formality. Real authority to act for the corporation flows from the act of voting, from the substantive decision embodied in the vote of directors, whether reduced to writing or not. What the Government *failed* to prove was substantive, not formal: it failed to prove that Farms was *not* operated by its own directors, while in the directors' minutes of both corporations there is much evidence to the contrary. The United States had, and still has, the burden of proof in this case.

Admittedly the two corporations had common officers, and some common directors, but that is not against public

policy. To act in multiple capacties is a commonplace of modern life. The Court of Appeals referred to this as a "fiction" and as wearing "hats" (A8). It might as well have said masks. But it is *not* a fiction. A given individual may serve in a given day as a member of the church vestry, as secretary of his alumni association, as a partner in a law firm and as a director in a corporation. This is not a "fiction" to be seen through, but an obvious fact to be accepted. Clearly, one can serve as an officer in two corporations without this being evidence of "total domination and control", of one by the other. This can be confusing, e.g., where A, B and C are serving as officers and directors of two corporations, but it needn't be. It should perhaps clarify the matter to think of them as A′, B′ and C′ when they are meeting as directors or officers of the subsidiary, because it is for whom they are working and what they are doing that defines them. To sum up, the only domination and control shown by this record consists of voting control by Chemicals in electing the directors of Farms. That is not improper. The kind of control which a court of equity should be concerned with would exist if a committee of one corporation supplanted the board of directors of its subsidiary, making its decisions and generally running its affairs. As to whether Farms had any "separate mind, will or existence" of its own, the resolutions of both corporations clearly show that it did.

Petitioners have sought to show that Farms was a fact, not a fiction, thereby provoking the observation of the Court of Appeals, "While we generally recognize a corporation's attempt to assume the guise of a subsidiary, even this expedition into fantasyland has its bounds." (A19). Farms was not a fantasy. It was a legally organ-

ized corporation. As this Court observed in *Klein v. Board of Supervisors,* 282 U.S. 19, 24 (1930), (Holmes, J.),

> "But it leads nowhere to call a corporation a fiction. If it is a fiction, it is a fiction created by law with intent that it should be acted on as if true."

This Court has also said,

> "Philosophy may have gained by the attempts in recent years to look through the fiction to the fact and to generalize corporations, partnerships and other groups into a single conception But to generalize is to omit, and, in this instance, to omit one characteristic of the complete corporation, as called into being under modern statutes, that is most important in business and law. A leading purpose of such statutes and of those to act under them is to interpose a non-conductor, through which, in matters of contract, it is impossible to see the man behind."

Donnell v. Herring-Hall-Marvin Safeco, 208 U.S. 267, 273 (Holmes, J.). Farms, like General Motors, was a system of activities carried on by human beings with real and personal property within a legal framework set up by the Legislature. Petitioners submit that to disregard its existence so as to hold is sole stockholder liable would be a deprivation of property without due process of law.

The law in this area is, as the Court of Appeals observed, a legal quagmire enveloped in the mists of metaphor. A judgment of $4.7 million has been entered against Petitioners without any showing of inequitable conduct on the part of Chemicals. The Court of Appeals threw up its hands and adopted the "factors" approach "in lieu of articulating a coherent doctrinal basis for the alter ego

theory." (A6). This Court should *provide* the coherent doctrinal basis of the alter ego theory which is necessary to a correct decision of this case and similar cases.

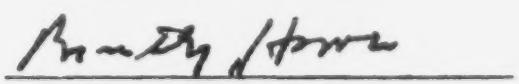
VII.

The Court of Appeals declined to review the district court's determination that Thomas was acting as president of Chemicals when he committed the crimes, saying that this was immaterial because the alter ego doctrine furnished a basis for vicarious liability, whether he was acting for Chemicals or not (A19). If this Court sees fit to grant the writ of certiorari with respect to the vicarious liability of Chemicals for the crimes of Farms, Petitioners submit that the Court should also set aside the finding of agency, in view of the stipulations to the effect that Thomas was acting only in his capacity as president of Farms in committing these crimes.

CONCLUSION

A writ of certiorari should issue to the United States Court of Appeals for the Fifth Circuit.

Respectfully submitted,



BRANTLY HARRIS
Two Shell Plaza, Suite 2299
777 Walker Street
Houston, Texas 77002
(713) 228-3040

Attorney for Jon-T. Chemicals, Inc., and Lewis M. Overton, Jr., Receiver for Jon-T. Chemicals, Inc.

CERTIFICATE OF SERVICE

Three copies of the foregoing Petition for a Writ of Certiorari were mailed to the Solicitor General, Department of Justice, Washington, D.C. 20530, on this 13 day of December, 1985.

Brantly Harris

BRANTLY HARRIS

APPENDIX A

UNITED STATES of America,
Plaintiff-Appellee,

v.

JON-T CHEMICALS, INC., and Lewis M. Overton, Jr., Receiver for Jon-T Chemicals, Inc.,
Defendants-Appellants.

No. 84-1325.

United States Court of Appeals,
Fifth Circuit.

August 16, 1985.

Appeal from the United States District Court for the Northern District of Texas.

Before GOLDBERG, POLITZ, and WILLIAMS, Circuit Judges.

GOLDBERG, Circuit Judge:

This is the latest installment in a series of cases that threatens to become, in its own small way, a latter-day *Jarndyce and Jarndyce*.[1] The cases arose as a result of fraudulent misrepresentations by John H. Thomas, Lonnie D. Clark, and Jon-T Farms, Inc., to obtain agricultural subsidies under the Upland Cotton Program.[2]

---

1. C. Dickens, *Bleak House* (1853).

2. The Upland Cotton Price Support Program was authorized by §§ 601-610 of the Agricultural Act of 1970, Pub. L. No. 91-524, 84 Stat. 1358 (codified at 7 U.S.C. § 1444(e)), and was administered by the Commodity Credit Corporation and the Agricultural Stabilization and Conservation Service of the Department of Agriculture. The Program is fully described in *United States v. Batson*, 706 F.2d 657, 659-66 (5th Cir. 1983), and *United States v. Clark*, 546 F.2d 1130, 1132 (5th Cir. 1977).

Initially, the government sought and obtained criminal convictions against these defendants, which we subsequently affirmed on appeal. *United States v. Thomas,* 593 F.2d 615 ("*Thomas I*") (affirming in part and remanding in part), *modified on rehearing,* 604 F.2d 450 (1979) (per curiam), *aff'd after remand,* 617 F.2d 436 (5th Cir.), *cert. denied,* 449 U.S. 841, 101 S. Ct. 120, 66 L.Ed.2d 48 (1980); *United States v. Clark,* 546 F.2d 1130 (5th Cir. 1977). The government then brought a civil action to recover the erroneously-paid subsidies, obtaining a summary judgment against Thomas, Clark, and Jon-T Farms based on the collateral estoppel effect of their criminal convictions. *United States v. Thomas,* 709 F.2d 968 (5th Cir. 1983) ("*Thomas II*") (affirming lower court decision). Now, the government seeks to hold liable the parent company of Jon-T Farms—Jon-T Chemicals—on the ground that Farms was its alter ego or agent.

The district court, sitting without a jury, found that Jon-T Chemicals exercised total domination and control over Jon-T Farms and that consequently Farms was the alter ego of Chemicals. On this basis, it entered judgment against Chemicals in the amount of $4,787,604.20. Because the district court applied the correct legal standard and made findings of fact that are not clearly erroneous, we affirm.

I

Jon-T Chemicals, an Oklahoma corporation, was incorporated in 1969 as a fertilizer and chemicals business. The following year, John H. Thomas became its majority shareholder as well as its president and board chairman, positions which he retained throughout the 1970 to 1973 period.

In April 1971, Chemicals incorporated Jon-T Farms as a wholly-owned subsidiary to engage in the farming and land-leasing business. Chemicals initially invested $1,000 to establish Farms, but later raised this investment to $10,000. All of the directors and officers of Farms were directors and officers of Chemicals, and Thomas served as the president and chairman of both corporations. In addition, Farms used the offices, computer, and accountant of Chemicals without paying any fee; Chemicals paid the salary of Farms's only regular employee; and Chemicals made ongoing, informal advances to Farms to pay Farms's expenses, reaching $1.8 million by the end of 1973 and $7.1 million in January 1975.

In 1972 and 1973, Thomas, along with other business associates (including a number of directors, officers, and employees of Chemicals and Farms), formed two cotton farming joint ventures. The ventures leased land from Farms and employed a custom farmer. On behalf of the ventures, Thomas and Farms submitted fraudulent applications for agricultural subsidies under the Upland Cotton Program. As a result of these applications, the Commodity Credit Corporation ("CCC") paid the joint ventures $2,263,601.15 in subsidies in the form of forty-two sight drafts. In addition, Thomas and Farms converted the proceeds of five other CCC sight drafts totalling $269,901.90.

After obtaining criminal convictions against Thomas and Farms, the Government commenced this civil action against Thomas, Farms, and Chemicals in June 1978, alleging violations of the False Claims Act, 31 U.S.C. §§ 231-235 (current version at 31 U.S.C. §§ 3729-3731

(1982)), and common law conversion.[3] Initially, the district court granted partial summary judgment against Thomas and Farms, finding them jointly and severally liable for the false representations and conversions. Before the district court awarded damages however, Farms went into bankruptcy, and further proceedings against it were stayed pursuant to 11 U.S.C. § 362 (1982). The district court therefore entered final judgment only against Thomas, finding him liable in the amount of $4,787,604.20. This judgment against Thomas has been affirmed on appeal. *Thomas II*, 709 F.2d 968.

Presumably because both Thomas and Farms were insolvent, the Government proceeded to press its claims against Chemicals.[4] The district court found that Farms was a mere appendage of Chemicals and that therefore Chemicals was liable for the illegal acts of Farms. Accordingly, it entered final judgment against Chemicals, holding it jointly and severally liable with Thomas for the $4,787,604.20. After the district court denied several post-trial motions by Chemicals, Chemicals brought this appeal.

II

[1, 2] Although Chemicals raises nine issues on appeal, these all boil down to a single question: Did the district court err in finding that Farms was the alter ego

---

3. The Government also named another individual in the suit, Lonnie Clark, and obtained a judgment against him, which we subsequently affirmed. *Thomas II*, 709 F.2d 968. The government, however, does not seek to hold Chemicals liable for the judgment against Clark.

4. These claims had earlier been severed by the district court from the Government's claims against Thomas and Farms.

of Chemicals?[5] If Farms was the alter ego of Chemicals, then Chemicals is liable for torts committed by Farms, as the district court held. In reviewing the court's alter ego finding, we first consider whether the court applied the correct legal standard[6] and then examine its factual findings.

---

5. In addition to attacking the district court's alter ego finding, Chemicals also challenges two subsidiary factual findings relating to the alter ego question, three findings relating to Chemicals' actual participation in the fraudulent misrepresentations and conversions, and the denial by the district court of Chemicals' three post-trial motions. Because we uphold the district court's alter ego finding, we need not consider the court's findings regarding Chemicals' actual participation in Farms's illegal acts. Nor need we consider separately the denial of the post-trial motions, since these depended on the court's alter ego finding, which we affirm.

6. Because the present case involves "rights of the United States arising under nationwide federal programs," federal law governs. *United States v. Kimbell Foods, Inc.*, 440 U.S. 715, 726, 99 S. Ct. 1448, 1457, 59 L.Ed.2d 711 (1979); *see also Clearfield Trust Co. v. United States*, 318 U.S. 363, 366-67, 63 S. Ct. 573, 575, 87 L.Ed. 838 (1943). The more difficult problem is to determine the appropriate rule of decision. In *Kimbell Foods*, the Supreme Court elaborated a three-part test to determine whether courts should adopt a uniform federal rule of decision or follow state law when resolving controversies affecting the operations of federal programs. 440 U.S. at 728-29, 99 S. Ct. at 1458-59. Under this test, we must examine (1) the need for a uniform federal rule; (2) the degree to which "application of state law would frustrate specific objectives of the federal program;" and (3) "the extent to which application of a federal rule would disrupt commercial relationships predicated on state law." *Id.*

In a related context, the Third Circuit held that, under the *Kimbell Foods* test, a uniform federal alter ego test should be used to determine when to allow the government to pierce the corporate veil in order to obtain Medicare reimbursements. *United States v. Pisani*, 646 F.2d 83, 86-87 (3rd Cir. 1981); *see also Audit Services Inc. v. Rolfson*, 641 F.2d 757, 764 (9th Cir. 1981) (applying federal alter ego standard in federal labor law case). Here we find no need to determine whether a uniform federal alter ego rule is required, since the federal and state alter ego tests are essentially the same. Our non-diversity alter ego cases have rarely stated whether they were applying a federal or state standard, and have cited federal and state

A

[3, 4] Under the doctrine of limited liability, the owner of a corporation is not liable for the corporation's debts. Creditors of the corporation have recourse only against the corporation itself, not against its parent company or shareholders. *See Baker v. Raymond International,* 656 F.2d 173, 179 (5th Cir. 1981), *cert. denied,* 456 U.S. 983, 102 S. Ct. 2256, 72 L.Ed.2d 861 (1982). It is on this assumption that "large undertakings are rested, vast enterprises are launched, and huge sums of capital attracted." *Anderson v. Abbott,* 321 U.S. 349, 362, 64 S. Ct. 531, 537-38, 88 L. Ed. 793 (1944).

[5, 6] While limited liability remains the norm in American corporation law, certain equitable exceptions to the doctrine have developed. The most common ex-

---

cases interchangeably. *See, e.g., Talen's Landing, Inc. v. M/V Venture,* 656 F.2d 1157, 1160-62 (5th Cir. 1981) (admiralty case); *Baker v. Raymond Int'l,* 656 F.2d 173, 179-81 (5th Cir. 1981) (Jones Act and admiralty case), *cert. denied,* 456 U.S. 983, 102 S. Ct. 2256, 72 L.Ed.2d 861 (1982); *National Marine Service, Inc. v. C.J. Thibodeaux & Co.,* 501 F.2d 940 942-43 (5th Cir. 1974) (contract and admiralty case). *Pisani* itself, one of the few circuit court opinions applying an explicitly federal rule of decision, adopted the test enunciated in *DeWitt Truck Brokers v. W. Ray Flemming Fruit Co.,* 540 F.2d 681 (4th Cir. 1976), a case involving South Carolina law. *Pisani,* 646 F.2d at 88; *see also Carpenters Health & Welfare Fund v. Kenneth R. Ambrose, Inc.,* 727 F.2d 279, 284 (3d Cir. 1983) (following *Pisani* and *DeWitt*); *Valley Finance, Inc. v. United States,* 629 F.2d 162, 171-72 (D.C. Cir. 1980) (citing *DeWitt*), *cert. denied,* 451 U.S. 1018, 101 S. Ct. 3007, 69 L.Ed.2d 389 (1981). Without deciding whether the federal and Texas alter ego doctrines are equivalent in all respects, we believe that they overlap at least with regard to the principles involved in the present case. *Compare Baker,* 656 F.2d at 180-81 (applying federal law); *Pisani,* 646 F.2d at 88 (same); *Valley Finance,* 629 F.2d at 172 (same) *with Nelson v. International Paint Co.,* 734 F.2d 1084, 1092-93 (5th Cir. 1984) (applying Texas law); *Miles v. AT & T,* 703 F.2d 193, 195-96 (5th Cir. 1983) (same).

ception is for fraud. If, for example, a corporation is established for a fraudulent purpose or is used to commit an illegal act, or if its shareholders drain the corporation's assets, limited liability may not apply. Another exception arises where, as here, a parent company totally dominates and controls its subsidiary, operating the subsidiary as its business conduit or agent. *See Nelson v. International Paint Co.*, 734 F.2d 1084, 1091-93 (5th Cir. 1984) (applying Texas law); *Edwards Co. v. Monogram Industries*, 730 F.2d 977, 980-82 (5th Cir. 1984) (en banc) (same); *Miles v. AT & T*, 703 F.2d 193, 195 (5th Cir. 1983) (same); *Baker*, 656 F.2d at 179-81 (applying Jones Act and admiralty law).

> [T]he control required for liability under the 'instrumentality' rule amounts to total domination of the subservient corporation, to the extent that the subservient corporation manifests no separate corporate interests of its own and functions solely to achieve the purposes of the dominant corporation. As Professor Fletcher states:
>
> > The control necessary to invoke what is sometimes called the "instrumentality rule" is not mere majority or complete stock control but such domination of finances, policies and practices that the controlled corporation has, so to speak, no separate mind, will or existence of its own and is but a business conduit for its principal.
>
> 1 W. Fletcher, [Cyclopedia of the Law of Private Corporations] § 43 at 204-05 [rev. perm. ed. 1963].

Krivo Industrial Supply Co. v. National Distillers & Chemical Corp., 483 F.2d 1098, 1106 (5th Cir. 1973) (applying Alabama law). In such cases, the subsidiary is considered the "alter ego," "agent," or "instrumentality"

of the parent company, and the district court, acting in its equitable capacity, is entitled to pierce the corporate veil.

[7] The complementary theories of limited liability and piercing the corporate veil have provoked consternation among courts and legal scholars alike. They have been variously described as a "legal quagmire," Ballentine, *Separate Entity of Parent and Subsidiary Corporations,* 14 Calif. L. Rev. 12, 15 (1925), and as being "enveloped in the mists of metaphor," *Berkey v. Third Avenue Ry.,* 244 N.Y. 84, 155 N.E. 58, 61 (1926) (Cardozo, J.); *see Krivo,* 483 F.2d at 1103 (quoting Ballantine and Cardozo). Nowhere is this more true than in the case of the alter ego doctrine. In some sense, every subsidiary is the alter ego of its parent company. Where the subsidiary is wholly-owned by the parent and has the same directors and officers, operating the subsidiary independently of the parent company not only has little practical meaning, it would also constitute a breach both of the subsidiary's duty to further the interests of its owner, and of the directors' and officers' duty towards the parent company. Nevertheless, our cases are clear that one-hundred percent ownership and identity of directors and officers are, even together, an insufficient basis for applying the alter ego theory to pierce the corporate veil. *Nelson,* 734 F.2d at 1092; *Miles,* 703 F.2d at 195. Instead, we maintain the fiction that an officer or director of both corporations can change hats and represent the two corporations separately, despite their common ownership.

[8] In lieu of articulating a coherent doctrinal basis for the alter ego theory, we have instead developed a laundry list of factors to be used in determining whether

a subsidiary is the alter ego of its parent. These include whether:

(1) the parent and the subsidiary have common stock onwership;

(2) the parent and the subsidiary have common directors or officers;

(3) the parent and the subsidiary have common business departments;

(4) the parent and the subsidiary file consolidated financial statements and tax returns;

(5) the parent finances the subsidiary;

(6) the parent caused the incorporation of the subsidiary;

(7) the subsidiary operates with grossly inadequate capital;

(8) the parent pays the salaries and other expenses of the subsidiary;

(9) the subsidiary receives no business except that given to it by the parent;

(10) the parent uses the subsidiary's property as its own;

(11) the daily operations of the two corporations are not kept separate; and

(12) the subsidiary does not observe the basic corporate formalities, such as keeping separate books and records and holding shareholder and board meetings.

Nelson, 734 F.2d at 1093; *Miles,* 703 F.2d at 195-96; *Baker,* 656 F.2d at 180. *See generally* Douglas & Shanks, *Insulation from Liability Through Subsidiary Corporations,* 39 Yale L.J. 193 (1929). Additional factors that are sometimes mentioned are (1) "[w]hether the directors and officers of [the subsidiary] act independently in the interest of that company, or whether they take their orders from the [parent] and act in the [parent's] interest," *Baker,* 656 F.2d at 180; and (2) the "connection of [the] parent's employee, officer or director to [the] subsidiary's tort or contract giving rise to [the] suit," *Miles,* 703 F.2d at 196. Analytically, however, these last two factors are on a different plane from the other factors. The first is, in essence, the conclusion that we reach through our alter ego analysis and thus depends on the preceding factors. When the directors and officers of the subsidiary are also directors and officers of the parent, it makes little sense to ask whether they take orders from the parent since they themselves constitute the parent's decision-making body and are duty-bound to act in the parent's interest. The second factor relates more to the involvement of the parent itself in the acts giving rise to the suit than to its vicarious liability for the subsidiary's acts in general.

In the present case, there is no doubt that the district court applied the proper legal standard. While recognizing that limited liability represents the general rule, the court noted that, under certain circumstances, courts may pierce the corporate veil—including where a subsidiary is completely dominated by its parent. As the court understood, the alter ego question depends upon the totality of the facts. The court listed ten factors that are indicative of total domination, following the test elaborated in *Baker,*

656 F.2d at 180, and *Bay Sound Transportation Co. v. United States,* 350 F.Supp. 420, 426 (S.D. Tex. 1972), *aff'd,* 474 F.2d 1397 (5th Cir. 1973), *cert. denied,* 415 U.S. 916, 94 S. Ct. 1413, 39 L.Ed.2d 471 (1974), and concluded, after considering these factors, that Farms was the alter ego of Chemicals.

Although Chemicals does not directly challenge the legal standard applied by the court below, it implicitly raises two objections. First, Chemicals contends that a finding of fraud is an essential element of any alter ego determination. According to Chemicals, unless a parent intentionally misleads outsiders, uses the corporate form for fraudulent purposes, or milks the subsidiary's assets, then it is entitled to hide behind the corporate veil of its subsidiary. Chemicals argues that since Farms was established for a proper business purpose—i.e., tax advantages —and since neither Chemicals nor Farms misled outsiders regarding their relationship and finances, the district court erred in piercing the corporate veil.

[9, 10] We disagree. Recently, we held that, in contract cases, fraud is an essential element of an alter ego finding. *Edwards,* 730 F.2d at 980-81. However, we do not require a finding of fraud in tort cases, *id.* at 982; *accord Bucyrus-Erie Co. v. General Products Corp.,* 643 F.2d 413, 419 (6th Cir. 1981) (applying Ohio law); *Valley Finance, Inc. v. United States,* 629 F.2d 162, 172 (D.C. Cir. 1980) (applying federal common law), *cert. denied,* 451 U.S. 1018, 101 S. Ct. 3007, 69 L.Ed.2d 389 (1981), particularly where the subsidiary is undercapitalized, *Nelson,* 734 F.2d at 1092; *cf. Anderson v. Abbott,* 321 U.S. 349, 362, 64 S. Ct. 531, 538, 88 L.Ed. 793 (1944) ("The cases of fraud make up part of that exception [to limited liability]. But they do not exhaust it.

An obvious inadequacy of capital . . . has frequently been an important factor in cases denying stockholders their defense of limited liability."); *DeWitt Truck Brokers, Inc. v. W. Ray Flemming Fruit Co.*, 540 F.2d 681, 684 (4th Cir. 1976) (contract case applying South Carolina law and holding that fraud is not a necessary element of alter ego finding). The reason for this distinction is clear. In a contract case, the creditor has willingly transacted business with the subsidiary. If the creditor wants to be able to hold the parent liable for the subsidiary's debts, it can contract for this. Unless the subsidiary misrepresents its financial condition to the creditor, the creditor should be bound by its decision to deal with the subsidiary; it should not be able to complain later that the subsidiary is unsound. In a tort case, by contrast, the creditor has not voluntarily chosen to deal with the subsidiary; instead, the creditor relationship is forced upon it. Thus, the question of whether the creditor relied on misrepresentations by the subsidiary is irrelevant. Where a parent establishes a subsidiary, undercapitalizes it, and dominates it to such an extent that the subsidiary is a mere conduit for the parent's business, then the parent should not be able to shift the risk of loss due to the subsidiary's tortious acts to innocent third parties. *See Nelson*, 734 F.2d at 1092; *Edwards*, 730 F.2d at 982; *Miles*, 703 F.2d at 195.

Here, the Government's claims for fraudulent misrepresentation and conversion sound in tort rather than contract.[7] Moreover, the Government did not voluntarily enter into the relationship with Farms. It did not have

---

7. Chemicals' reliance on a number of contract cases applying Texas law—among them, *Bell Oil & Gas Co. v. Allied Chem. Corp.*, 431 S.W.2d 336 (Tex. 1968), and *Atomic Fuel Extraction Corp. v. Slick's Estate*, 386 S.W.2d 180 (Tex. Civ. App. 1964)—is therefore misplaced.

the option of granting or not granting the subsidies to the joint ventures. Under the Upland Cotton Program, it was obligated to subsidize applicants who purportedly qualified. 7 U.S.C. § 1444(e). The fact that the Government did not rely on any misrepresentations regarding Farm's financial condition or its relationship with Chemicals is thus wholly irrelevant to the question whether Chemicals should be held liable for Farm's misconduct. Unlike the ordinary contracting party, the Government was not dilatory in any duty to investigate Farm's finances, since it had no such duty. As long as Chemicals exercised total domination and control over Farms, it was liable for Farm's acts.

Chemicals also contends that the district court gave insufficient weight to the fact that Farms observed all of the formalities required by corporation law, including keeping separate books and records and holding regular meetings of shareholders and of the board of directors. According to Chemicals, as long as corporate forms were observed by the subsidiary, then the corporate form must also be observed by the courts.

[11] Our only reply is that Chemicals puts form ahead of substance. We agree with the view expressed by the Fourth Circuit that "in applying the 'instrumentality' or 'alter ego' doctrine, the courts are concerned with reality and not form, with how the corporation operated and the individual defendant's relationship to that operation." *DeWitt Truck Brokers,* 540 F.2d at 685. "[T]he subsidiary must be more than a corporate charter embellished by a few formal niceties. We cannot, as in the case of the Emperor's new clothes, pretend to see something which does not exist." *Edwards Co. v. Monogram Industries,* 700 F.2d 994, 1002, *vacated,* 715 F.2d 157 (1983),

reversed, 730 F.2d 977 (5th Cir. 1984) (en banc). In determining whether a subsidiary is the alter ego of its parent, we apply a multifactor test. One of these factors is whether the corporate formalities were observed—but this is only one of several factors; it is not determinative.[8] Thus, Chemicals' argument that Farms observed the corporate formalities goes merely to the weight of the evidence, not to the correctness of the legal standard applied by the district court.

B

[12] As we have noted, there is no litmus test for determining whether a subsidiary is the alter ego of its parent. Instead, we must look to the totality of the circumstances. Resolution of the alter ego issue is heavily fact-specific and, as such, is peculiarly within the province of the trial court. Consequently, in reviewing the district court's finding, we apply the clearly erroneous standard of review. *Talen's Landing, Inc. v. M/V Venture,* 656 F.2d 1157, 1159-60 (5th Cir. 1981); *George W. Bennett*

---

8. Although the district court did not explicitly list "observation of corporate formalities" as one of the factors in its analysis, it correctly noted that an alter ego finding depends on the totality of the circumstances, and recognized that its list of factors was illustrative rather than exhaustive. We do not require a district court to list and expressly consider every factor that might be relevant to an ultimate factual issue. This would convert even a simple issue into a lengthy ordeal and would virtually ensure that a district judge would hear only a handful of cases in his or her lifetime. Previously, we have held that the illustrative factors listed by the district court are adequate when contained in a jury instruction regarding the alter ego question, *Baker,* 656 F.2d at 181 & n. 7, and can properly be relied on by the factfinder in a bench trial, *Bay Sound Transp.,* 474 F.2d at 1398. We therefore fail to perceive any error in the district court's failure to include "observation of corporate formalities" in its illustrative list of the factors that determine a corporation's alter ego status.

Bryson & Co. v. Norton Lilly & Co., 498 F.2d 328, 329, *reh'g denied*, 502 F.2d 1045, 1049 (5th Cir. 1974); *accord Valley Finance, Inc. v. United States*, 629 F.2d 162, 172 (D.C. Cir. 1980), *cert. denied*, 451 U.S. 1018, 101 S. Ct. 3007, 69 L.Ed.2d 389 (1981); *DeWitt Truck Brokers v. W. Ray Flemming Fruit Co.*, 540 F.2d 681, 684 (4th Cir. 1976); *cf. Pullman-Standard v. Swint*, 456 U.S. 273, 287, 102 S. Ct. 1781, 1789, 72 L.Ed.2d 66 (1982) (clearly erroneous rule applies to ultimate findings of fact as well as to subsidiary findings of fact). We will reverse only if, after reviewing the evidence as a whole, we are "left with the definite and firm conviction that a mistake has been committed." *United States v. United States Gypsum Co.*, 333 U.S. 364, 395, 68 S. Ct. 525, 542, 92 L.Ed. 746 (1948).

Here, the district court based its ultimate alter ego finding on a number of subsidiary findings. These subsidiary factual findings, like the ultimate finding, "come here well armed with the buckler and shield of Fed. R. Civ. P. 52(a)." *Horton v. United States Steel Corp.*, 286 F.2d 710, 713 (5th Cir. 1961). We consider them first and then turn to the court's ultimate finding regarding Farms's alter ego status.

First, Chemicals challenges the district court's finding that Farms "operated with a grossly inadequate capital." Memorandum Opinion at 4, Finding of Fact 5. Chemicals claims that although Farms initially had only $10,000 in capital, it subsequently received millions of dollars in advances for working capital from Chemicals. According to Chemicals, Farms could not have been undercapitalized since it had "virtually unlimited access to credit in the form of loans from its parent, Chemicals." Reply Brief of Appellants at 9. Our short answer to this is

that if Farms had unlimited access to the coffers of Chemicals, this access should have been sufficient to pay involuntary creditors who were prejudiced by the limited funds in Farms's own coffers. In our view, Chemicals' argument misses the point. The underlying question is whether Farms was an economically viable, independent entity or whether it operated merely as the adjunct or alter ego of Chemicals. The fact that Farms continually had net operating losses and survived due to massive and ongoing transfusions from Chemicals does not indicate that Farms ever stood on its own two feet. Quite the contrary; it reinforces the district court's conclusion that Farms did not have any separate financial existence. As the district court properly concluded, Farms operated primarily on the capital of Chemicals rather than its own capital.

Chemicals also claims that the district court erred in finding that Chemicals and Farms jointly used and owned property, Memorandum Opinion at 4, Finding of Fact 7, and that they commingled their assets, *id.* at 7. In regard to the joint use of property, it is undisputed that Farms used the offices and computer of Chemicals. It is also undisputed, as the district court found, that Chemicals paid the expenses of several tractors used by Farms. Although Chemicals claims that these expenses were carried on its books as loans to Farms, given the pervasive interconnections between Farms and Chemicals, we do not regard the district court's finding regarding the joint ownership of property to be clearly erroneous.

[13] The district court's finding that there was a commingling of the corporate funds of Chemicals and Farms is similarly supported by the record. It is undisputed that Chemicals made ongoing advances to Farms. Basically,

whenever Farms could not pay its bills, Chemicals did so by writing a check. These intercorporate loans were handled informally, without any corporate resolutions authorizing them. Chemicals' accounting department, which also served as the accountant for Farms and for the joint ventures, would prepare daily account balances reflecting the daily balances of Chemicals, Farms, the joint ventures, and Chemicals' other subsidiaries. On the basis of these statements, funds were transferred between the different accounts in order to cover deficiencies. *Id.* at 5, Finding of Fact 10.

[14] Although Chemicals claims that there was no commingling of funds because records were kept of each advance made by Chemicals to Farms, we agree with the district court that these records did not reflect the true economic realities and that the officers and directors treated the two corporations as one corporate enterprise. *Id.* Chemicals admits that no collateral was posted for the "loans" it made to Farms and does not contest that Farms paid no interest on the loans. While we do not denigrate careful recordkeeping of corporate transactions, we do not regard mere records as a philosophers' stone capable of transmuting alter egos into distinct corporations. Records are primarily a memorialization of economic reality, not constitutive of that reality.

[15] Having found the district court's subsidiary findings to be supported by the record, we have little trouble in affirming the court's ultimate finding that Farms is the alter ego of Chemicals. Indeed, Chemicals, while disputing that it exercised day-to-day control over Farms or participated in Farms' crimes, admits that "[t]he evidence in this case is mainly to the effect that Chemicals controlled or dominated Farms." Brief of Appellants at 36.

To mention just some of the evidence supporting the district court's alter ego holding, all of the directors and officers of Farms served as directors and officers of Chemicals; Farms was wholly owned by Chemicals; Chemicals paid many of the bills, invoices, and expenses of Farms; it covered Farms's overdrafts; it made substantial loans to Farms (at one time amounting to $7 million) without corporate resolutions authorizing the loans and without demanding any collateral or interest; Chemicals and Farms filed consolidated financial statements and tax returns; Farms used the offices and computer of Chemicals without paying any rent; the salary of Farms's one regular employee was paid by Chemicals; and employees of Chemicals performed services for Farms without charging for their time. Chemicals also advanced money and provided services on an informal basis to the joint ventures. Although the evidence in the record does not all point in one direction—the fact, for example, that Farms observed corporate formalities supports its separate corporate existence—it was for the factfinder (in this case the district court) to weigh the evidence and to determine, based on the totality of the evidence, whether an alter ego relaionship existed.[9]

[16] Finally, Chemicals argues that the Government never proved that Chemicals participated in the joint ventures, and, in particular, in the wrongdoing resulting in the improper subsidy payments. According to Chemi-

---

9. In *Edwards Co. v. Monogram Industries*, 730 F.2d 977 (5th Cir. 1984) (en banc), on similar facts, we reversed a panel opinion that held as a matter of law that a subsidiary was the alter ego of its parent. 700 F.2d 994 (5th Cir. 1983). We did not indicate, however, that a district court finding of alter ego status would have been clearly erroneous in that case. Nor were the facts of *Edwards* identical to the facts at issue here. We therefore do not regard *Edwards* as controlling.

cals, it cannot be held responsible because it did not engage in any wrongdoing. This argument, however, begs the alter ego question. The purpose of the alter ego analysis is to determine whether Chemicals is vicariously liable for Farms's actions—that is, whether actions by Farms are considered to be actions by Chemicals. Thus, even if Chemicals were correct that Thomas filed the false forms and improperly converted the five sight drafts in his capacity as president of Farms rather than of Chemicals, this is irrelevant given the district court's ultimate finding, based on a consideration of the evidence as a whole, that Farms was the alter ego of Chemicals.

III

A corporation unlike Proteus, cannot assume a new form at will. While we generally recognize a corporation's attempt to assume the guise of a subsidiary, even this expedition into fantasyland has its bounds. Here, as in *National Marine Service, Inc. v. C.J. Thibodeaux & Co.*, 501 F.2d 940 (5th Cir. 1974), "[t]he corporate veil with which appellants would enrobe [the subsidiary] to give it the semblance of being attired in corporate clothing was so diaphanous that the district court was well able to see through it." *Id.* at 943.

AFFIRMED.

APPENDIX B

IN THE UNITED STATES DISTRICT COURT
FOR THE NORTHERN DISTRICT OF TEXAS
LUBBOCK DIVISION

CIVIL ACTION NO. CA-5-78-75A

UNITED STATES OF AMERICA,
Plaintiff,

v.

JON-T. CHEMICALS, INC., and LEWIS M. OVERTON, JR., Receiver for Jon-T. Chemicals, Inc.,
Defendants.

JUDGMENT

This action came on for trial before the court, with the undersigned Judge presiding, and the issues having been duly tried and a decision having been duly rendered,

It is Ordered and Adjudged that the plaintiff, United States of America, recover of and from the defendants, Jon-T. Chemicals, Inc. and Lewis M. Overton, Jr., receiver for Jon-T. Chemicals, Inc., jointly and severally with John H. Thomas the sum of $4,787,604.20 together with interest thereon as provided in the judgment dated June 18, 1982 in Cause No. CA-5-78-75, *United States of America v. John H. Thomas.*

Costs are taxed against the defendants.

The Clerk will furnish a copy hereof to each attorney.

ENTERED this 27th day of February, 1984.

/s/ HALBERT O. WOODWARD
Halbert O. Woodward
Chief Judge
Northern District of Texas

B2

IN THE UNITED STATES DISTRICT COURT
FOR THE NORTHERN DISTRICT OF TEXAS
LUBBOCK DIVISION

CIVIL ACTION NO. CA-5-78-75A

UNITED STATES OF AMERICA,
Plaintiff,

v.

JON-T. CHEMICALS, INC., and LEWIS M. OVERTON, JR., Receiver for Jon-T. Chemicals, Inc.,
Defendants.

MEMORANDUM OPINION

The above case came on for trial before the court without a jury commencing on the 16th day of February, 1984, with all counsel, parties, and witnesses in attendance.

After hearing and considering the evidence, the pleadings of the parties and the argument of counsel, the court files this memorandum opinion which shall constitute the court's findings of fact and conclusions of law.

On June 18, 1982, this court entered a judgment in Cause No. CA-5-78-75, *United States of America v. John H. Thomas,* in the amount of $4,787,604.20 as recovery by the government for forty-two erroneously paid sight drafts, less certain credits, and for conversion as set forth in Counts I and III of the complaint. This judgment was affirmed by the United States Court of Appeals for the Fifth Circuit in *United States of America v. John H. Thomas,* 709 F.2d 968 (5th Cir. 1983). Previously, on January 3, 1980, this court ruled that

Jon-T. Farms, Inc. ("Farms") was jointly and severally liable with John H. Thomas under the False Claims Act and for conversion.

The United States of America has filed its claim against Jon-T. Chemicals, Inc. ("Chemicals"), and its receiver, the defendants in this case, alleging that Chemicals is liable for all amounts awarded in the judgment against John H. Thomas on the theory that Farms, a corporation which is jointly and severally liable on said judgment, was the alter ego of Chemicals.

The court agrees with the position of the United States of America and finds and concludes that the facts in this case establish the alter ego relationship between Chemicals and its receiver and Farms, its wholly owned subsidiary.

The court incorporates herein and adopts the stipulations and agreements as to certain facts between the parties as set forth in the Pre-Trial Order of this court, approved by all attorneys, and which Pre-Trial Order was filed with the Clerk on February 7, 1984 and is here attached and referred to for all purposes.

Though the general rule is that a corporation is not liable for the acts of its subsidiary, under certain circumstances, most notably the prevention of fraud, courts may pierce the corporate veil and hold controlling parties liable for the acts of their instrumentality. *See Baker v. Raymond International, Inc.*, 656 F.2d 773 (5th Cir. 1981). Determination of the alter ego question is based upon consideration of the totality of the facts and is made on a case-by-case basis. Among the factors to be considered indicating complete domination of a subsidiary by the parent are:

1) ownership of all or a majority of the stock of the subsidiary

2) common officers or directors

3) incorporation of the subsidiary by the parent

4) financing of the subsidiary by the parent

5) undercapitalization of the subsidiary

6) payment of salary and expenses of the subsidiary by its parent

7) use of parent property by the subsidiary

8) lack of independent action of the subsidiary

9) no dividends paid

10) the directors or officers of the subsidiary not acting independently in the interest of the subsidiary, but taking orders from the parent in the latter's interest.

See Id.; Bay Sound Transportation Co. v. U. S., 350 F. Supp. 420, 426 (S.D. Tex. 1972), *aff'd* 474 F.2d 1397 (5th Cir. 1973) (per curiam) *cert. denied* 415 U.S. 916 (1974). Federal courts also disregard the corporate entity in order to " 'prevent fraud, illegality, or injustice, or where recognition of the corporate entity would defeat public policy . . .'." *U. S. v. James W. Thomas,* 515 F. Supp. 1351, 1357 (W.D. Tex. 1981), *citing Zubik v. Zubik,* 384 F.2d 267, 272 (3d Cir. 1967) *cert. denied* 390 U.S. 988 (1968).

The findings of fact in this opinion and the stipulations of the parties establish the following:

1. Chemicals owned all of the stock in Farms. Stipulation No. 19.

2. During the period in question in this case, the years of 1972 and 1973, the officers of both corporations were identical, that is John H. Thomas was president, Earl M. Weddle was vice-president, and Darrell L. Miller was secretary (comptroller or vice-president in charge of finances) for each of the corporations. Further, during this period, the board of directors of each corporation was either identical or overlapping, with John H. Thomas as chairman of each board. Stipulations 8, 9, 30, 31, 213.

3. Farms was incorporated by John H. Thomas, Earl M. Weddle, Jr. and Darrell L. Miller, officers of Chemicals. Chemicals, acting through its officers and directors, caused the incorporation of Farms. Stipulation 16. Chemicals, acting by and through its officers and directors, appointed John H. Thomas as attorney to represent Chemicals at Farms' shareholders' meetings. Stipulations 27, 28.

4. Originally Farms was incorporated with a capital of $1,000.00, but was subsequently changed to $10,000.-00. Stipulation 23. The record is replete with instances of advances and sums paid by Chemcals to Farms to finance its operations and it is without question that Chemicals financed the operations of its wholly owned subsidiary, Farms. *See e.g.* Stipulations 113, 114, 117, 118, 119, 120, 121.

5. After examining the original capital structure of the corporation, as above set forth, and the amounts subsequently borrowed by Farms from Chemicals and the large sums of money needed to operate Farms, the court finds that Farms operated with a grossly inadequate capital.

6. The brother of John H. Thomas, H. C. Thomas, was the only regular employee of Farms, and his salary as an employee of Farms was paid by checks drawn on Chemicals. See Exs. 44(a)-44HH. In many instances expenses which were incurred by Farms were approved by Thomas for payment by Chemicals.

7. There was a joint use of property by the corporations. In certain cases, large equipment would be paid for by Chemicals when used by Farms in its operations and it appears that the officers, directors, and employees of the corporations considered the property to be owned jointly by these corporations. *See e.g.* Stipulations 169, 180.

8. John H. Thomas was the controlling stockholder of Chemicals and, through Chemicals, fully controlled its wholly owned subsidiary, Farms. The evidence does not indicate that the directors and officers of Farms acted independently in the interest of Farms but rather treated it as a division of Chemicals even though Farms was separately incorporated and had a separate legal identity under the law because of its separate incorporation. This separate identity caused by the separate incorporation was not sufficient to prevent the piercing of the corporate veil.

9. The record does not establish that Farms ever paid a dividend through its entire corporate existence.

10. The transactions between the corporations show that there was a constant balance of moneys due and owing by Farms to its parent company, Chemicals. It is apparent that these transactions were paper transactions only while in truth and in fact the officers and directors treated the two corporations as one corporate enterprise.

Chemicals's accounting department prepared daily account balances reflecting the daily balances of Chemicals, Farms, the joint ventures, and the other subsidiaries. On the basis of these statements, funds were transferred between accounts in order to cover deficiencies. *See* Stipulations 110, 111, 112, 113. Inter-corporate loans were a usual occurrence and were handled informally.

11. The transactions which resulted in the liability of John H. Thomas and Farms for the False Claims Act and conversion were dealings by Farms and Chemicals with joint enterprise ventures known as Gaines County Farms and GACO. These joint ventures in effect obtained payments under the agricultural programs of the United States of America because certain false statements were made showing their entitlement to these payments. Chemicals and Farms were engaged in the management and direction of these joint ventures. John H. Thomas was the principal actor in perpetrating the fraud upon the United States government and did so in his capacity as the president of Chemicals as well as his individual direction of the corporate affairs and of his direction of the joint ventures. In effect Chemicals and Farms participated in the fraudulent transactions alleged under the False Claims Act. For example, Chemicals participated in the fraud in the following respects:

a) Members of the joint ventures included Chemicals' shareholders, directors, officers, and employees.

b) Robert E. Kennedy was an officer and employee of Chemicals and handled the accounting for Chemicals and its subsidiary and for the joint ventures. Kennedy was a member of the GACO

joint venture. Darrell L. Miller was a director, officer, and employee of Chemicals, and was a director and officer of Farms. Miller was a member of the Gaines County Farms joint venture. Miller and Kennedy served as the conduit between the joint ventures and their banks. Kennedy handled joint venture operations out of Chemicals' offices.

c) Letters from joint venture members and the banks were addressed to Kennedy or Miller, Jon.-T Chemicals, Brownfield, Texas.

d) Chemicals advanced funds to the GACO joint venture. Stipulations 131, 132, 207, 280.

e) Charles R. Bruce was the custom farmer for the joint ventures and Farms. Bruce (or Bruce Farm Service), however, received payment from Chemicals for services performed for Farms or the joint ventures. Bruce also received substantial advances from Chemicals. Stipulations 162-169.

12. Chemicals and Farms had the same business address and occupied the same premises, and there is no evidence that Farms ever paid any rent or provided any other service for Chemicals. In fact, the accounting and bookkeeping work performed on behalf of Farms was done and performed by an employee of Chemicals who was wholly paid by Chemicals and not by any funds provided by Farms.

The evidence in this case firmly establishes that there was a co-mingling and integration of all of the corporate activities of each corporation, as well as a co-mingling of their corporate funds, and in each instance there was

a direction and supervision by Chemicals and its officers and directors of the activities and functions of Farms to such an extent that they can only be considered as one enterprise.

The evidence fully establishes sufficient facts to pierce the corporate veil and this court has concluded that Farms is the alter ego of Chemicals, acted in such capacity, and therefore its acts in such capacity place Chemicals in the position of liability for the judgment entered on June 18, 1982, against John H. Thomas in the amount of $4,787,604.20.

Judgment will be entered in accordance with the above.

The Clerk will furnish a copy hereof to each attorney.

ENTERED this 27th day of February, 1984.

/s/ HALBERT O. WOODWARD
Halbert O. Woodward
Chief Judge
Northern District of Texas

[Attached to the Memorandum Opinion were pages 4-49 of the Pre-Trial Order (R. 383), containing 252 stipulations. Those stipulations pertinent to this appeal are treated in the text of the Petition for Writ of Certiorari.]

IN THE UNITED STATES DISTRICT COURT
FOR THE NORTHERN DISTRICT OF TEXAS
LUBBOCK DIVISION

CIVIL ACTION NO. CA-5-78-75A

UNITED STATES OF AMERICA,
Plaintiff,

v.

JON-T. CHEMICALS, INC., and LEWIS M. OVERTON, JR., Receiver for Jon-T. Chemicals, Inc.,
Defendants.

ORDER

Following a trial on the merits, the Court, on February 27, 1984, entered its judgment against defendants Jon-T. Chemicals, Inc. and Lewis M. Overton, Jr., Chemicals' Receiver. The defendants have filed motions for a new trial, to amend the Court's findings and make additional findings, and to alter or amend the judgment.

Upon consideration of the defendants' post-trial motions, the opposition thereto filed by the United States and the entire record herein, it is

ORDERED that the defendants' motions be, and the same hereby are, denied.

ENTERED this 3rd day of April, 1985.

/s/ HALBERT O. WOODWARD
Halbert O. Woodward
Chief Judge
Northern District of Texas

APPENDIX C

31 U.S.C. § 3729

A person not a member of an armed force of the United States is liable to the United States Government for a penalty of $2,000, an amount equal to 2 times the amount of damages the Government sustains because of the act of that person, and costs of the civil action, if the person—

> (1) knowingly presents, or causes to be presented, to an officer of employee of the Government or a member of an armed force a false or fraudulent claim for payment or approval;
>
> (2) knowingly makes, uses, or causes to be made or used, a false record or statement to get a false or fraudulent claim paid or approved;

* * *

31 U.S.C. § 3730

(a) The Attorney General diligently shall investigate a violation under section 3729 of this title. If the Attorney General finds that a person has violated or is violating section 3729, the Attorney General may bring a civil action under this section against the person.

* * *

31 U.S.C. § 3731

* * *

(b) A civil action under section 3730 of this title must be brought within 6 years from the date the violation is committed.